HELP ?

EMU and international conflict

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Abstract:
If, as seems most likely, EMU does occur and does lead to a political union with an independent military and foreign policy, the US must rethink its own foreign policy with respect to Europe, as EMU will change the political character of Europe in ways that could lead to conflicts in Europe and confrontations with the US. First, the US would have an opportunity to play a new, useful role within Europe, helping to balance national pressures and prevent the inevitable conflicts from developing into more serious confrontations. Second, the US must be aware that an economically and politically unified Europe would seek a different relationship within the US. Finally, the US must recognize that it would no longer be able to count on Europe as an ally in all its relations with third countries.

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MONNET WAS MISTAKEN

TO MOST Americans, European economic and monetary union seems like an obscure financial undertaking of no relevance to the United States. That perception is far from correct. If EMu does come into existence, as now seems increasingly likely, it will change the political character of Europe in ways that could lead to conflicts in Europe and confrontations with the United States.

The immediate effects of EMU would be to replace the individual national currencies of the participating countries in 2002 with a single currency, the euro, and to shift responsibility for monetary policy from the national central banks to a new European Central Bank (ECB). But the more fundamental long-term effect of adopting a single currency would be the creation of a political union, a European federal state with responsibility for a Europe-wide foreign and security policy as well as for what are now domestic economic and social policies. While the individual governments and key political figures differ in their reasons for wanting a political union, there is no doubt that the real rationale for EMU is political and not economic. Indeed, the adverse economic effects of a single currency on unemployment and inflation would outweigh any gains from facilitating trade and capital flows among the EMU members.1

The 1992 Maastricht Treaty that created the EMU calls explicitly for the evolution to a future political union. But even without that specific treaty language, the shift to a single currency would be a dramatic and irreversible step toward that goal. There is no sizable country anywhere in the world that does not have its own currency. A national currency is both a symbol of sovereignty and the key to the pursuit of an independent monetary and budget policy. The tentative decision of the 15 European Union (EU) member states (with the exceptions of Denmark and the United Kingdom), embodied in the Maastricht Treaty, to abandon their national currencies for the euro is therefore a decision of fundamental political significance.

For many Europeans, reaching back to Jean Monnet and his contemporaries immediately after World War II, a political union of European nations is conceived of as a way of reducing the risk of another intra-European war among the individual nation-states. But the attempt to manage a monetary union and the subsequent development of a political union are more likely to have the opposite effect. Instead of increasing intra-European harmony and global peace, the shift to EMu and the political integration that would follow it would be more likely to lead to increased conflicts within Europe and between Europe and the United States.

What are the reasons for such conflicts? In the beginning there would be important disagreements among the EMU member countries about the goals and methods of monetary policy. These would be exacerbated whenever the business cycle raised unemployment in a particular country or group of countries. These economic disagreements could contribute to a more general distrust among the European nations. As the political union developed, new conflicts would reflect incompatible expectations about the sharing of power and substantive disagreements over domestic and international policies. Since not all European nations would be part of the monetary and political union, there would be conflicts between the members and nonmembers within Europe, including the states of Eastern Europe and the former Soviet Union.

Conflicts would also develop between the European political union and non-European nations, including the United States, over issues of foreign policy and international trade. While disagreements among the European countries might weaken any European consensus on foreign affairs, the dominant countries of the EU would be able to determine the foreign and military policies for the European community as a whole. A political union of the scale and affluence of Europe and the ability to project military power would be a formidable force in global politics.

Although 50 years of European peace since the end of World War II may augur well for the future, it must be remembered that there were also more than 50 years of peace between the Congress of Vienna and the Franco-Prussian War. Moreover, contrary to the hopes and assumptions of Monnet and other advocates of European integration, the devastating American Civil War shows that a formal political union is no guarantee against an intra-European war. Although it is impossible to know for certain whether these conflicts would lead to war, it is too real a possibility to ignore in weighing the potential effects of EMU and the European political integration that would follow.

THE POLITICS AND ECONOMICS OF MONETARY POLICY

THE MOST direct link between EMu and intra-European conflicts would be disagreement about the goals and methods of monetary policy. The Maastricht Treaty established the ECB and transfers all responsibility for monetary policy after the start of EMU from individual national central banks to the ECB. The ECB alone would control the supply of euros and set the short-term euro interest rate.

Maastricht makes price stability the primary objective of European monetary policy, paralleling the charter of Germany's Bundesbank. The treaty also provides that the ECB would be independent of all political control by the member states and by European-level political institutions. (Although the treaty states that the ECB will report to the European Parliament, this was intended to follow the Bundesbank tradition of an information report rather than any political oversight.) These conditions are very much what Germany wants for the ECB and for monetary policy. Because of its historical experience, the German public is hypersensitive on inflation and fears any monetary arrangement that does not give primacy to price stability and insulate monetary policy from political influence.

But German opinion differs sharply from the opinions about monetary policy in France and other European countries. The notion of a politically independent central bank is contrary to European traditions. Until recently, when Maastricht required all prospective EMU countries to give their central banks independence, most of the central banks of Europe reported to their ministries of finance, and the finance ministers were at least partially responsible for setting interest rates.

The French have been particularly vocal in calling for political control over monetary policy. In a televised speech just before the 1992 French referendum on the Maastricht Treaty, then-President Francois Mitterrand assured the French public that, contrary to the explicit language of the treaty, European monetary policy would not be under the direction of European central bankers but would be subject to political oversight that, by implication, would be less concerned with inflation and more concerned with unemployment. Mitterrand's statement was a political forecast; France recognizes that the institutions of the EMU would evolve, and continually presses for some form of political body to exert control over the ECB. It has already made considerable progress toward that end.

The December 1996 meeting of the EU Council of Ministers in Dublin emphasized that growth as well as price stability would be an explicit goal of future EMU monetary policy. It also established a new ministeriallevel "stability council" described as a "complement" or a "counterweight" to the ECB. Although this body falls short of one that could exercise political control over the ECB, it marked a first French success in establishing that monetary policy should be subject to some counterweight and that growth (that is, short-run macroeconomic expansion) as well as price stability should be a goal of EMU policy. At the European summit in Amsterdam in June 1997, the newly elected French government of Lionel Jospin made further progress. The summit added an employment chapter to the Maastricht Treaty, emphasizing that employment is a parallel goal to price stability. More important, statements by politicians at the Amsterdam summit appear to have redefined the role of the political authorities in making exchange rate policy and, therefore, in managing monetary policy.

More specifically, the Maastricht Treaty divided responsibility for exchange rate policy between the ECB and the Eu Economics and Finance Council, which consists of cabinet ministers of member governments, in an ambiguous way. The drafters of that part of the treaty (the German participants in particular) intended to limit ECOFIN's role to fundamental aspects of the exchange rate system and to leave to the ECB policies that cause short-run changes in the value of the euro. For example, a decision to fix the exchange rate between the euro and the Japanese yen permanently would be a decision for ECOFIN. In contrast, raising or lowering euro interest rates to increase or decrease the exchange value of the euro would be left to the ECB. Although this distinction was the German view, the French expected that ECOFIN would eventually get to give orders about short-run variations in the desired level of the euro exchange rate. The formal rules remain ambiguous, but the government leaders at the Amsterdam summit appear to have accepted a shift of responsibility for short-run exchange rate policy to ECOFIN. Since discretionary changes in nominal exchange rates can be achieved only by changes in monetary policy, this shift would establish a much more fundamental role for ECOFIN, a political body, in the making of monetary policy.

One further recent development relating to the independence of the ECB is noteworthy. Members of the key monetary policy committee of the European Parliament have called for a role for the parliament in supervising the ECB, including its interest rate policies. They have specifically pointed to congressional oversight of the U.S. Federal Reserve as a possible model for such supervision. Although this arrangement may strike a reasonable balance between independence and accountability, parliamentary oversight would clearly be a major shift from the complete independence called for in the Maastricht Treaty, and consequently an area for contention.

At present, individual European governments (especially in France and Germany) are suppressing their disagreement about the control of monetary policy to minimize the risk of political disapproval of EMU in their respective countries. But if EMU proceeds, the independence of the ECB and the goals of monetary policy will become a source of serious conflict among member countries.

INFLATION VERSUS UNEMPLOYMENT

THE ISSUE of who controls monetary policy is closely related to the question of the proper goal of monetary policy. In recent years, because of the Maastricht Treaty's requirements for entering EMU, most countries have resisted the temptation to use monetary policy to reduce unemployment and have followed the Bundesbank in keeping inflation rates below three percent. But once the disciplining example of the Bundesbank is eliminated and monetary policy is made by an ECB in which all member countries vote equally, there is a strong risk that the prevailing sentiment will be for higher inflation. Over the past iz months, international financial markets have anticipated that outcome by depressing the value of the deutsche mark, the French franc, and the other European currencies that move with them by 25 percent relative to the dollar and the yen.

If the German public sees the inflation rate rise under EMU, it will become increasingly antagonistic toward the EMu arrangement and toward the countries that vote for inflationary monetary policy. Moreover, since an inflationary monetary policy would lower unemployment only temporarily (while leaving the inflation rate permanently higher), the persistence of high unemployment would lead to political pressure for recurring rounds of expansionary monetary policy, causing continuing dissatisfaction among the anti-inflationary countries.

Countries that are more concerned about unemployment than inflation might nevertheless be critical of the ECB for not pursuing an even more aggressive expansionary policy. Although countries have been properly reluctant to attempt such policies in recent years, they can regard their decisions not to do so as decisions they made themselves. But with a single currency, such governments would suffer the frustration of not being able to decide for themselves and of being forced to accept the common monetary policy created by the ECB.

This general conflict about the governance and character of monetary policy would be exacerbated whenever a country experienced a decline in exports or other type of decline in aggregate demand that led to a cyclical increase in unemployment. The shift to a single currency would mean that the fall in demand in a country could not be offset, as it could be with an individual national currency, by an automatic decline in the exchange value of the currency (making its exports more competitive) and a decline in its interest rates (increasing domestic interest-sensitive spending by households and businesses) or by using its own monetary policy to shift interest rates and exchange rates. The ECB would have to make monetary policy with a view to the conditions in all of Europe, not just a particular country or region. The result would be a conflict between the country with rising unemployment and the rest of the EU.

TAXES AND TRANSFERS

WI T H o U T T H E automatic countercyclical response of financial markets and the ability to use monetary policy to offset a decline in demand, European governments would want to use tax cuts and increases in government outlays to stimulate demand and reverse cyclical increases in unemployment. But the "stability pact" that was adopted under pressure from Germany tells governments that they cannot run fiscal deficits above three percent of GDP after the start of EMU. This restriction creates an important source of tension between countries with cyclical unemployment increases and the other members of the monetary union. The decision at the 1997 Amsterdam summit to weaken the application of financial penalties for violating this deficit ceiling would undoubtedly encourage more violations and, therefore, more quarrels about "irresponsible" fiscal policies.

Since national monetary and fiscal policies would be precluded, the most likely outcome of the shift to a single monetary policy would be the growth of substantial transfers from the EU to countries that experience cyclical increases in unemployment. Financing those transfers would require a significant increase in tax revenues collected by the EU.

The debates about how large such transfers should be and how the taxes to finance them should be collected would exacerbate the more general disagreement that will inevitably arise as the union seeks to restrict the level and structure of the taxes that individual countries may levy. The European Commission is already trying to get countries to move toward more coordination of their domestic tax policies on the grounds that existing differences in tax rates and rules create competitive advantages for some countries. The shift to a single currency would increase the pressure for tax harmonization. As general responsibility for economic policy shifts from national capitals to the European Commission, the European tradition of focusing taxing authority at a single level would be likely to lead to a shift of the exclusive taxing power from the national to the European level. The EU will therefore be disregarding national preferences about redistribution, the size of government, and the structure of taxes. While the pressures for such coordination might be overwhelming once a single currency has been adopted, the loss of national control over taxes and transfers would be another serious source of irritation within the EU.

LONG-TERM UNEMPLOYMENT

As THE decisions shift away from national governments, it will become harder to reach agreement on policy changes to deal with the high unemployment due to excessive regulation and social welfare payments. The shift of policy decisions from national governments to the European level would eliminate the ability to learn from the experiences of individual countries that try different policies and to benefit from the competitive pressures to adopt national policies that succeed. Moreover, the changes in labor market rules and social benefits that have been proposed by certain national governments are now being opposed not only by labor unions within the individual countries but also by other European governments that fear the resulting gains in competitiveness. Thus we hear of opposition to "social dumping" when an inefficient enterprise is closed and witness the imposition of a Europe-wide limit on the number of hours that employees can work. A politically more unified Europe would make it easier to enforce policies that prevent changes in national labor laws or national transfer payments that would reduce structural unemployment and increase national competitiveness.

If EU legislation succeeds in preventing member countries from competing with each other, they will collectively become less able to compete with the rest of the world. The result would undoubtedly be pressure for increased EU trade barriers, justified by reference to differences in social policy between Europe and other countries. European imposition of such protectionist policies would undermine the entire global trading system and create serious conflicts with the United States and other trading partners.

INCOMPATIBLE EXPECTATIONS

As THE monetary union evolves into a more general political union, conflicts would arise from incompatible expectations about the sharing of power. France sees Emu and the resulting political union as a way of becoming a comanager of Europe and an equal of Germany, which has nearly 50 percent more people. In the economic sphere, the current domination of European monetary policy by the Bundesbank would be replaced by that of the EcB, in which France and Germany would sit and vote as equals. As the French contemplate the eventual membership of the economic and political union, they may also hope that their natural Mediterranean allies, Italy and Spain, will give France a decisive influence on European policies. And the skillful international French civil servants might come to dominate the administration of the European government.

Germany's expectations and aspirations are more difficult to interpret. Some German leaders no doubt believe, as Chancellor Helmut Kohl frequently says, that joining a political union improves the prospects for peace by "containing a potentially dangerous Germany within Europe." Other Germans are no doubt less self-sacrificing and simply disagree with the French assessment of the consequences of greater economic and political integration. They see Germany as the natural leader within the Eu because of its economic weight, military capability, and central location in an Eu that will soon include Poland, the Czech Republic, and Hungary. As Kohl has said, not without ambiguity, "Germany is our fatherland, but Europe is our future."

What is clear is that a French aspiration for equality and a German expectation of hegemony are not consistent. Both visions drive their countrymen to support the pursuit of EMu, and both would lead to disagreements and conflicts when they could not be fulfilled.

The aspirations of the smaller countries to have a seat at the table may be frustrated. As the Eu expands from 15 current members to include at least 6 more countries of Eastern Europe, the role that smaller countries will be allowed to play will become more and more limited. Current EU voting rules will give way to weighted voting arrangements in which the larger countries have a predominant share of the votes. This change will frustrate countries that recognize that they have sacrificed the ability to control their own domestic policies and their own foreign relations without having received in exchange an effective say in Europe's policies.

This loss of sovereignty would affect not just monetary and tax policies but a wide range of current domestic policies that will gradually come under the jurisdiction of the European Commission or European Parliament. Rule-making by the European Commission reached a crescendo in 1994 with edicts about such things as the quality of beer and the permissible shape of imported bananas. A fear that complaints about bureaucratic meddling could jeopardize approval of the Maastricht Treaty in national referendums led to a reduction in rule-making by the Brussels bureaucracy and a rhetorical emphasis on Maastricht's principle of "subsidiarity," which asserts that activities will be assigned to whatever level of government is most appropriate-European, national, or local. There is, however, little reason to believe that this vague principle will do much to restrain the substitution of Brussels rules or Strasbourg legislation for what are now domestic policies. Even the Tenth Amendment to the U.S. Constitution, which reserves to the states (or to the people) any powers not delegated to the national government, has not prevented the shift of power to the national government over an enormous range of local issues, such as speed limits on local roads and the age at which individuals may consume alcohol.

A EUROPEAN MILITARY AND FOREIGN POLICY

THE COLLAPSE of the Soviet Union has changed the basis for European foreign policy and military collaboration. Although the United States and the countries of Western Europe have had an extremely close alliance since the end of World War II and continue to coordinate military efforts within the NATO structure, many Europeans in positions of responsibility see their economic interests and foreign policy goals differing from those of the United States with respect to many parts of the world, including Eastern Europe, the Middle East, Africa, and even Latin America. The French and German governments also want to develop an independent military capability that can operate without U.S. participation or consent.

Although the European nations could now more readily pursue an independent foreign policy and military strategy, they are clearly hampered in doing so effectively by the decentralized political structure of Europe. Chancellor Konrad Adenauer summarized the situation in stark terms for French Foreign Minister Christian Pineau on the day in 1956 when England and France gave in to American pressure to abandon their attack on the Suez Canal: "France and England will never be powers comparable to the United States and the Soviet Union. Nor Germany, either. There remains to them only one way of playing a decisive role in the world; that is to unite to make Europe. England is not ripe for it but the affair of Suez will help to prepare her spirits for it. We have no time to waste: Europe will be your revenge."2 That was a year before the Treaty of Rome launched the Common Market.

The creation of a political union based on the EMU with explicit authority to develop a common foreign and defense policy would accelerate the development of an independent European military structure capable of projecting force outside Western Europe. Steps in that direction are already occurring in anticipation of the stronger political union that will follow the start of EMU. In March 1997, on the 4oth anniversary of the Treaty of Rome, France and Germany announced their desire to see a merger of the EU with the existing European military alliance, the Western European Union, so as to strengthen the military coordination of European nations outside the NATO framework. An explicit agreement was reached with the United States that will allow the European members of NATO to use European NATO forces and equipment under European control without U.S. participation.

The attempt to forge a common military and foreign policy for Europe would be an additional source of conflict among the member nations (as well as with those outside the group). European countries differ in their national ambitions and in their attitudes about projecting force and influencing foreign affairs. An attempt to require countries like Portugal and Ireland to participate in an unwanted war in the Middle East or Eastern Europe could create powerful conflicts among the European nations.

THE RISK OF WAR

THERE IS No doubt that a Europe of nearly 300 million people with an economy approximately equal in size to that of the United States could create a formidable military force. Whether that would be good or bad in the long run for world peace cannot be foretold with any certainty. A politically unified Europe with an independent military and foreign policy would accelerate the reduction of the U.S. military presence in Europe, weaken the role of NATO, and, to that extent, make Europe more vulnerable to attack. The weakening of America's current global hegemony would undoubtedly complicate international military relationships more generally.

Although Russia is now focusing on industrial restructuring, it remains a major nuclear power. Relations between Russia and Western Europe are important but unpredictable. Might a stronger Russia at some time in the future try to regain control over the currently independent Ukraine? Would a stronger, unified EU seek to discourage such action by force? Could that lead to war between Russia and the Eu? How would a strong and unified Europe relate to other nations in the vicinity, including those of North Africa and the Middle East, and the Muslim states of the former Soviet Union, which are important or potential sources of energy for Western Europe?

War within Europe itself would be abhorrent but not impossible. The conflicts over economic policies and interference with national sovereignty could reinforce long-standing animosities based on history, nationality, and religion. Germany's assertion that it needs to be contained in a larger European political entity is itself a warning. Would such a structure contain Germany, or tempt it to exercise hegemonic leadership?

A critical feature of the EU in general and EMU in particular is that there is no legitimate way for a member to withdraw. This is a marriage made in heaven that must last forever. But if countries discover that the shift to a single currency is hurting their economies and that the new political arrangements also are not to their liking, some of them will want to leave. The majority may not look kindly on secession, either out of economic self-interest or a more general concern about the stability of the entire union. The American experience with the secession of the South may contain some lessons about the danger of a treaty or constitution that has no exits.

IMPLICATIONS FOR THE UNITED STATES

IF, AS SEEMS most likely, EMU does occur and does lead to a political union with an independent military and foreign policy, the United States must rethink its own foreign policy with respect to Europe. First, the United States would have an opportunity to play a new, useful role within Europe, helping to balance national pressures and prevent the inevitable conflicts from developing into more serious confrontations. The United States should therefore emphasize that it wants its relations with the individual nations of Europe to remain as strong as they are today and should not allow Brussels to intervene between Washington and the national capitals of Europe.

Second, the United States must be aware that an economically and politically unified Europe would seek a different relationship with the United States. French officials in particular have been outspoken in emphasizing that a primary reason for a European monetary and political union is as a counterweight to the influence of the United States, both within European and in international affairs more generally. For the French, American influence is an old issue that frustrated de Gaulle and recurs in attacks on American "cultural imperialism" and U.S. attempts to influence Europe's policies toward countries like Libya, Iraq, and Iran. Such issues would become more widespread in a powerful, independent Europe.

Finally, the United States must recognize that it would no longer be able to count on Europe as an ally in all its relations with third countries. It was safe to assume such support when conflict with the Soviet Union dominated international relations and Europe's interest in containing the Soviet Union coincided with America's. But the global configuration of relations is now more complex. And the Europeans, guided by a combination of economic self-interest, historical traditions, and national pride, may seek alliances and pursue policies that are contrary to the interests of the United States. Although this divergence may tend to happen in any case because of the apparent end of the Soviet threat, the creation of a monetary union that led to a strong political union would accelerate it. If EMU occurs and leads to such a political union in Europe, the world will be a very different and not necessarily safer place.

[Footnote]

II have discussed the economic costs and benefits of EMU for Europeans in "The Case Against EMU," The Economist, June 13, 1992, pp. 12-19, and in "The Political Economy of the European Economic and Monetary Union: Political Sources of an Economic Liability,"Journal of Economic Perspectives, Fall 1997, forthcoming.

[Footnote]

2Quoted in Henry Kissinger, Diplomacy, New York: Simon & Schuster, 1994, P. 547.

[Author note]

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